Audit Report

OFFICE OF THE INSPECTOR GENERAL

AUDIT OF COST-PLUS-AWARD-FEE CONTRACTS

Report No. 96-019 October 31, 1995

Department of Defense

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INSPECTOR GENERAL
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Report No. 96-019

October 31, 1995

MEMORANDUM FOR DIRECTOR, DEFENSE PROCUREMENT
ASSISTANT SECRETARY OF THE NAVY (FINANCIAL MANAGEMENT AND COMPTROLLER)
ASSISTANT SECRETARY OF THE AIR FORCE (FINANCIAL MANAGEMENT AND COMPTROLLER)
AUDITOR GENERAL, DEPARTMENT OF THE ARMY

SUBJECT: Audit of Cost-Plus-Award-Fee Contracts (Project No. 5CA-0050)

Introduction

We are providing this report for your information and use. For the four cost-plus-award-fee contracts reviewed, the report discusses the adequacy of incentive amounts for contractors to reduce costs; the appropriateness of award fees; the effective use of cost-plus-award-fee contracts; and management controls and performance indicators over the cost-plus-award-fee contracts reviewed.

Audit Results

Award fees contained adequate incentive amounts for contractors to reduce costs for the four contracts reviewed. Methods to determine and compute award fees were adequate. Contracting officers at Fort Eustis, Newport News, Virginia, agreed to reevaluate the type of contract for base operating services during the next acquisition cycle in response to concerns expressed during the audit. We did not identify any material management control weaknesses. In addition, the objectives that performance indicators were to achieve were being accomplished through the evaluation plans for the contracts' award fee determination on all four contracts reviewed.

Audit Objectives

The audit objectives were to determine whether award fees contain adequate incentive amounts for contractors to reduce costs and whether the DoD contracting officers were effectively using cost-plus-award-fee contracts. We also reviewed the management control program and performance indicators as they related to the audit objectives.

Scope and Methodology

Audit Scope. We judgmentally selected four sample contracts for review. One contract was selected from each Military Department and the Army Corps of Engineers. We derived the sample from a list of FY 1994 contracting actions on cost-plus-award-fee type contracts. To derive the sample, we eliminated contracts for research and development work and contracts for environmental work from the universe. The universe remaining after the elimination process consisted of 80 contracts and 1,767 contracting actions totaling $923 million. The sample consisted of 4 contracts and 174 contracting actions totaling $20.7 million (2 percent of the universe). However, from calendar year 1989 through calendar year 1994, the three Military Departments and the Army Corps of Engineers expended $201.4 million on the sample contracts. Enclosure 1 lists details on the scope of the audit.

We reviewed the contract files for each of the four contracts reviewed, including the Determination and Finding analyses and basic contract agreement, to determine actual fees paid and procurement strategy. We reviewed Federal Acquisition Regulations for cost-plus-award-fee type contracts. We obtained copies of the payment history on the basic contract and analyzed the payment of award fee based on contractor performance. We determined whether the award fee was in compliance with statutory limitations for the service or product delivered. We also reviewed applicable management control procedures over cost-plus-award-fee contracting and determined whether DoD activities were complying with established regulations.

Termination of Audit Work. We decided that no additional audit work was necessary because a global review of cost-plus-award-fee contracts would not likely result in systemic issues and the additional audit costs would outweigh the benefits of doing the audit.

Audit Period, Standards, and Locations. This economy and efficiency audit was performed from May through June 1995 in accordance with auditing standards issued by the Comptroller General of the United States, as implemented by the Inspector General, DoD. We included tests of management controls considered necessary. We did not use computer-processed data or statistical sampling procedures for this audit. Enclosure 3 lists the organizations visited or contacted.

Management Control Program

DoD Directive 5010.38, "Internal Management Control Program," April 14, 1987, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls. We

reviewed the adequacy of management controls related to cost-plus-award-fee contracts. We did not assess the adequacy of management's self-evaluation of those controls. Management controls applicable to the cost-plus-award-fee contracts were deemed to be adequate in that we identified no material management control weaknesses for the four contracts reviewed.

Prior Audits and Other Reviews

The Inspector General, DoD, has performed one audit pertaining to the audit objectives. In addition, the Air Force Audit Agency has performed a related audit and as of May 1995, has been performing a followup audit. Enclosure 2 discusses both prior audit reports.

Audit Background

A cost-plus-award-fee contract is a cost-reimbursement contract that provides for a fee. The fee consists of a base amount fixed at the inception of the contract and an award amount. The contractor may earn all or part of the award fee based on subjective evaluation by the Government of the contractor's performance. The contractor's performance is evaluated in such areas as quality, timeliness, technical ingenuity, and cost-effectiveness. The award amount should be sufficient to provide motivation for excellence.

The objective of cost-plus-award-fee contracting is to negotiate a contract type and price (or estimated cost and fee) that will result in reasonable contractor risk and provide the contractor with the greatest incentive for efficient and economical performance. This type of contracting should be used when performance does not permit costs to be estimated with sufficient accuracy to use the fixed-price type of contracting.

Discussion

Adequacy of Incentive Amounts to Reduce Costs. Award fees contained adequate incentive amounts for contractors to reduce costs for the four contracts reviewed. In a cost-plus-award-fee contract, the major areas of performance such as management, technical ability, and cost are given relative weights in accordance with the agency's priorities. In the area of cost, the contractor is measured on his skill and ability to control, adjust, and project the cost aspects of the contract. The higher the weight assigned to the cost area, the greater the incentive for the contractor to reduce costs.

Federal Acquisition Regulation Requirements. The Federal Acquisition Regulation requires a motivation for excellence not wholly based on

cost and does not provide a specific percentage of the award fee that should be based on incentive to reduce costs. For the award fee determination on the contracts reviewed, the cost factor ranged in weight from 13 percent to 40 percent of the award fee. However, absent the criteria that designate a specific percentage, the incentive to reduce costs was deemed adequate.

Cost Portion of Award Fee Payments. For the contracts reviewed, the award fee paid in the cost category reflected the success or failure of the contractor to adequately control cost. For example, at Vandenberg Air Force Base, California, for contract F04703-91-C-0101, the contractor made adjustments that resulted in a fuel cost savings to the Government of approximately $1,800 per month. In addition, the contractor was able to procure a generator at a cost savings of $1,305 and a monitor at a cost savings of $5,728. The award fee paid to the contractor in the cost category reflected the success in reducing the cost.

Appropriateness of Award Fees. Overall, the method of determining award fees to the contractor and methods used to compute the award fee were adequate. However, a review of the award fee evaluations for Contract DACW01-89-C-0166 with the Army Corps of Engineers showed that the Award Fee Board scores were not always consistent with write-ups in the award criteria factor of performance. Seven out of nine statements listed under the award criteria factor of performance fit the description of average performance. As a result of the write-up, the score should have ranged from 71 to 80. However, the actual score given was 91.3, indicating outstanding performance. An analysis of these types of inconsistencies showed a overpayment that represents only 3 percent of the total award fee paid of $608,275. As a result, the amount was inconsequential and, therefore, no action was taken.

Effective Use of the Cost-Plus-Award-Fee Contract Type. Contracting officers should avoid continued use of a cost-reimbursement contract such as a cost-plus-award-fee contract after experience provides a basis for firmer pricing. Effective use of a contract type involves reevaluating the contract type as well as deciding to change the contract type when performance permits costs to be reasonably estimated within sufficient accuracy to use the fixed-price type of contract. For the Navy and Army Corps of Engineers contracts reviewed, the cost-plus-award-fee contract type was appropriate. The Vandenberg Air Force Base contract was appropriately revised through proper reevaluation. The Fort Eustis contract was improperly reevaluated.

Vandenberg. Contracting officers at Vandenberg Air Force Base appropriately revised its contract type from cost-plus-award-fee to fixed-price-incentive-fee because experience provided a basis for firmer pricing. The cost-plus-award-fee contract F04703-91-C-0101 at Vandenberg Air Force Base will be replaced with a new contract in September 1995 under the fixed-price-incentive-fee contract type. Originally, Vandenberg Air Force Base

justified the need for a cost-plus-award-fee type contract based on the work to be performed. Devising predetermined objective incentive targets was neither feasible nor effective in the areas of cost, technical performance, and schedule. However, observation of historical contract costs allowed the contracting personnel to estimate contract costs with sufficient accuracy to use a fixed-price type contract. By reevaluating the contract type, the contracting officer avoided continued use of a cost-reimbursement type contract after experience provided a basis for firmer pricing.

Fort Eustis. Unlike the reevaluation performed at Vandenberg Air Force Base, review of contract DABT57-89-C-0020 at Fort Eustis showed improper reevaluation of the contract type. We believe that costs could be estimated within sufficient accuracy to use the fixed-price type of contract. Specifically, the contractor has been providing base operating services for the past 13 years, and the yearly cost of the contract has been approximately $10.5 million, even with the various deployments of the 7th Transportation Group. The uncertainty of deployments was the basis for the use of the cost-plus-award-fee contract type. Fort Eustis agreed to reevaluate the type of contract during the next acquisition cycle.

Management Controls. Contracting officers at Vandenberg Air Force Base and the Army Corps of Engineers were complying with management control procedures over cost-plus-award-fee contracts. However, we had concerns about management controls at Fort Eustis and Naval Air Warfare Center Weapons Division, China Lake, California (China Lake).

o Fort Eustis did not properly reevaluate contract DABT57-89-C-0020 to determine whether a cost-plus-award-fee contract type is the appropriate type of contract to continue with contract DABT57-94-C-0027, the follow-on contract.

o China Lake's evaluating procedures at the technical level were weak for contract N60530-88-D-0019. China Lake had no definite guidance for the technical assistant to rate contractor performance in the good, satisfactory, or weak rating categories. The outstanding and unsatisfactory categories required a brief explanation. Another contract at China Lake showed a much more descriptive method of determining the award fee percentage. China Lake indicated a willingness to at least require an explanation for the good, satisfactory, and weak ratings for the next contract, which was awarded in May 1995.

Performance Indicators. Contracting personnel were not familiar with performance indicators at the four sites visited. Agencies are not required to submit performance indicators until September 1997 to comply with the Government Performance and Results Act of 1993. However, cost-plus-award-fee contracts evaluation criteria meet the intent of performance indicators as identified in the Government Performance and Results Act.

The evaluation criteria require calculation of award fees based on performance, which accomplishes the objectives that performance indicators were to achieve.

Management Action

Fort Eustis officials have strengthened management controls over cost-plus-award-fee contracts. Fort Eustis will reevaluate the type of contract during the next acquisition cycle, which will begin 18 to 24 months before the completion of the current contract, to include all available options. We consider the action taken to be responsive to our concern. Therefore, we are not making any recommendations.

Management Comments

We provided a draft of this report to you on August 21, 1995. Because the report contains no findings or recommendations, written comments were not required, and none were received. Therefore, we are publishing this memorandum report in final form.

We appreciate the courtesies extended to the audit staff. For additional information on this report, please contact Ms. Kimberley A. Caprio, Audit Program Director, at (703) 604-9248 (DSN 664-9248) or Ms. Carolyn R. Milbourne, Audit Project Manager, (703) 604-9241 (DSN 664-9241). Enclosure 4 lists the planned distribution of this report. The audit team members are listed inside the back cover.

David K. Steensma

David K. Steensma
Deputy Assistant Inspector General
for Auditing

Enclosures

Value of Contracts Reviewed

The following shows the four contracts reviewed during the audit and the value of each contract from January 1, 1989, through April 30, 1995.

Military Department	Services Performed	FY 1994 DD 350* (millions)	Contract Cost (millions)	Contract Period
Army	Base Operations Support Fort Eustis	$8.9	$ 50.0	1989 through 1994
Navy	Engineering Support Services China Lake, California	7.9	126.0	1989 through 1995
Air Force	Operations and Maintenance of Property and Equipment, Vandenberg Air Force Base, California	3.0	11.0	1990 through 1995
Army Corps of Engineers	Maintenance of Locks and Dams	5.4	14.4	1989 through 1994
Total Value		**$25.2**	**$201.4**	

*DD Form 350, "Individual Contracting Action Report."

Enclosure 1

Prior Audits and Other Reviews

One Inspector General, DoD, report and one Air Force Audit Agency report covered issues related to this audit.

Inspector General, DoD, Report No. 93-097, "Comprehensive Long-Term Environmental Action, Navy Contract," May 14, 1993, reports that the Navy paid higher award fees than the contractor was entitled to based on the contractor performance. As a result, the contractor had no incentive to correlate good performance with award fees. The report recommended that the Navy develop and implement procedures to address contract management and administration deficiencies, to standardize award fee computations, and to improve the award fee management process. Management concurred, stating that an alternative plan would be incorporated into all contracts.

Air Force Audit Agency Report of Audit 93294003, "Management of the Major Range and Test Facility Contract, 39th Space Wing, Vandenberg AFB, CA 93437-6261," October 19, 1993, reports that contract management did not properly incorporate the incentive fee clause, Federal Acquisition Regulation 52.216.10, into the range contract. The report recommended that the 30th Contracting Squadron commander request approval to deviate from the incentive fee clause or insert the clause as directed. Management nonconcurred, stating that management had a special contract provision that had the effect of implementing the incentive fee clause. The issue was evaluated for resolution. Air Force Audit Agency is currently performing a followup audit to this contract.

Organizations Visited or Contacted

Office of the Secretary of Defense

Office of the Under Secretary of Defense for Acquisition and Technology,
Washington, DC
Office of the Deputy Under Secretary of Defense (Advanced Technology),
Washington, DC

Department of the Army

Assistant Secretary of the Army (Research, Development, and Acquisition),
Washington, DC
Headquarters, Army Corps of Engineers, Washington, DC
Army Engineer District, Mobile, AL
Army Corps of Engineers, Columbus Area Office, Columbus, MS
Fort Monroe, Training and Doctrine Command, Hampton, VA
Fort Eustis, Army Transportation Center, Newport News, VA
Army Contracting Support Agency, Alexandria, VA
Army Audit Agency, Alexandria, VA

Department of the Navy

Assistant Secretary of the Navy (Financial Management and Comptroller),
Washington, DC
Headquarters, Naval Air Systems Command, Arlington, VA
Naval Air Warfare Center Weapons Division, China Lake, CA

Department of the Air Force

Assistant Secretary of the Air Force (Financial Management and Comptroller),
Arlington, VA
Western Space and Missile Center, Vandenberg Air Force Base, CA
Air Force Audit Agency, Arlington, VA

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- House Committee on Government Reform and Oversight
- House Subcommittee on National Security, International Affairs, and Criminal Justice, Committee on Government Reform and Oversight
- House Committee on National Security

Audit Team Members

This report was produced by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.

Paul J. Granetto
Kimberley A. Caprio
Carolyn R. Milbourne
James A. Wingate
Veronica G. McCain
Rhonda K. Mead
Dorothy L. Dixon

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